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Business in Brief

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Business activity is now moving up. And most signs point to a continued, though moderate, improvement this year.

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Industrial production rose 6% between August and December. That's a rate of advance which inevitably must slow down. About half the increase is explained by the rapid advance in auto and steel output. The rest reflects the end of inventory liquidation.

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The impetus from both factors will begin to wane in the months ahead. Auto output is running at a 7,500,000 a year rate—more than the industry expects to sell. It's the normal push to get ready for the heavy sales period between March and June.

The inventory turn-about was dramatic. Stocks were being cut at a $4.8 billion annual rate in the third quarter. By the year's end, purchasing was back almost to a normal replacement basis.

So most of the impetus from the inventory shift is behind us. **From now on increased output must be geared to increases in basic demand.**

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For perspective in viewing trends in basic demand, it is important to review the recent past. Our best clues to the future are found by analysis of recent trends.

It is now clear that the 1953-54 recession was one of the mildest on record. The drop in gross national product from top to bottom was $14 billion or 4%. We've already recovered almost half the lost ground. Here's what has happened to basic demand in major sectors of the economy—with areas that contributed to the downturn listed first.

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Government expenditures are down $10 billion from their peak rate in early 1953. Most of the decline shows up in defense. (See *Business In Brief*, July 1954). The President's budget message points to very little drop in defense from now on. Thus, the steady increase in state and local government expenditures should offset any further mild decline in defense spending.

The shift from building inventories in early 1953 to reducing them—a drop of $10 billion in spending—placed a drag on production. That drag has been removed, but there are few indications of a return to inventory accumulation.

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Business investment in new plants and equipment has tapered off moderately. But the spectacular rise in construction is more than offsetting that decline. Construction reached an all-time high of $37½ billion last year. Government estimates are that construction will rise 7% in 1955.

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The strength of consumer demand was one of the outstanding economic features of 1954. Consumer expenditures went up from a rate of $229 billion in the final quarter of 1953 to $236 billion at the end of 1954.

A rise of $7 billion in a recession year is a significant phenomenon. It points to the increased resiliency of our economy. The Administration's action in cutting personal taxes helped bolster consumer purchases.

Christmas sales broke all records. Surveys of consumer intentions show that people have been raising their buying plans for more than a year. These findings, together with the prospect of expanding personal income, point to a further—though moderate—rise in consumer expenditures.

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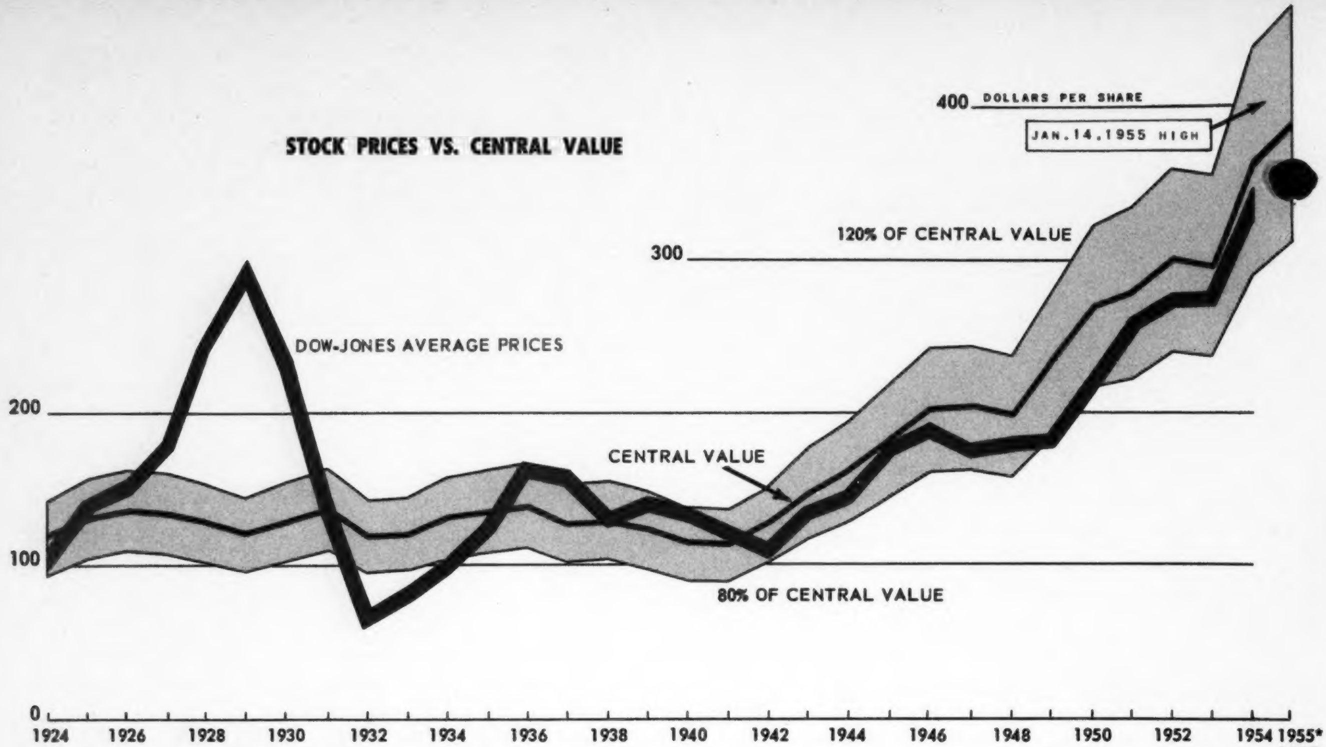
When you add up trends in all these areas, you reach this conclusion: 1955 promises, in general, to be a good year for business.

The question remains, however, as to whether the rise in business activity will be large enough to realize fully our huge growth potential (see page seven of this issue). The U.S. economy, great as it is, must continue to grow to provide jobs for more than 500,000 new workers each year and to translate increased efficiency into higher living standards. We have in most lines the productive capacity to support a substantial rise in output.

In short, the principal characteristic of the 1955 business scene promises to be a high level of activity marked by lively competition.



DATA: BENJAMIN GRAHAM "THE INTELLIGENT INVESTOR" NEW YORK, 1954, P.261.

STOCK MARKET TRENDS

The recent behavior of stock market prices raises this question: Just how high are prices in light of today's conditions? Common stock prices:

- Went up more than 40% during 1954 while business activity sagged;

- Reached an all-time high in late 1954—when the Dow-Jones industrial average hit 404, as against the 1929 top of 381.

Differences from 1929

When the market broke through its 1929 high there appeared a number of comparisons of today's situation with that in the late 1920's. Such comparisons at least serve the purpose of showing that market conditions are basically different today.

In the first place, the average price of common stocks relative to earnings and yields is not as high as it was in 1929. Here are pertinent comparisons for the Dow-Jones industrials:

	1929 High	1954 High
Dow-Jones Industrial Average....	\$381	\$404
Earnings per share, Previous Year.	\$ 15.36	\$ 27.23
Ratio: Price to Previous Year's Earnings	24.8	14.8
Dividend Yield	3.15%	3.99%
Yield on High-Grade Bonds	4.69%	2.89%

Clearly, in terms of standard comparisons, stock prices are now lower than they were a quarter century ago.

A second significant difference is that today's market is predominantly a cash market, whereas the 1929 boom was fueled by huge quantities of credit. The total amount of credit underlying the stock market now amounts to around 3% of the market value of all listed stocks. In 1929 the ratio of credit to market value was 25%.

All this highlights the fact that there is less speculation in stocks today. Common stocks were being bought on 10% or less margin in 1929. Now the required margin is 60%, and fewer buyers are trading on the margin.

However, all this evidence that common stocks are more conservatively valued than in 1929 throws little light on how prices actually stand in relation to the circumstances of 1955. To assess the present level of stock market averages, one should not compare them with 1929, but rather look at trend relationships over many years in such basic factors as earnings, dividend yields, interest rates and book values.

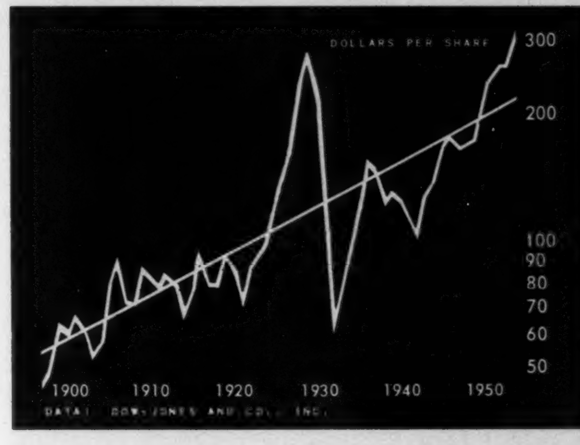
Trends in Prices and Earnings

First, consider the long-term relationship between stock prices and earnings. The chart at the top of the page compares the Dow-Jones industrial average with a "central value." The "central value" is computed by capitalizing average earnings of the ten previous years at twice the current yield on high-grade corporate bonds.

Experience since 1881 shows that the Dow-Jones industrials have normally fluctuated in a range defined as lying between 80% of the central value and 120% of it. The only time they moved out of this range for an extended period was in the boom of the late 1920's.

The Dow-Jones industrial average was well below the computed central value in late 1953 when the recent upsurge in the market began. At its high on January 3, however, the average was 5% above the central value for 1955. Yet it still was within the range that has generally characterized market fluctuations since 1881.

Consequently, this measure shows that while stock prices are on the high side historically, they're not as high in relation to average earnings as in most past periods that preceded a major break.



Stock and Bond Yields

The relative return available from investments in common stocks, as opposed to that from high-grade corporate bonds, has an obvious bearing on stock prices. Over the long pull the dividend yield on industrial common stocks has averaged 1.6 times the yield on Moody's Aaa corporate bonds. Since late 1953 the ratio of stock to bond yields has moved down from 1.83 to a current level of 1.54—only slightly below the long-term average. Moreover, it is well above the late 20's, 1937 and 1946.

Book Values

The Dow-Jones industrials are now selling at a price equal to almost 1.6 times book value. That's a higher ratio than in any period except 1929 and 1936-37, when the ratios reached 1.9 and 1.8 respectively—considerably above the current figure.

However, it must be remembered that book values do not yet fully reflect the post-war price inflation—a significant portion of corporate assets is still valued at prices below today's replacement costs.

Up to this point we have been looking backwards at trends that are relevant in assessing the level of common stock prices. However, the market's evaluation of future trends also has a large bearing on the level of prices.

Recent trends in corporate earnings and dividends point to a better showing this year than last. If the upturn in business activity runs on through the year, corporate earnings will show a good gain.

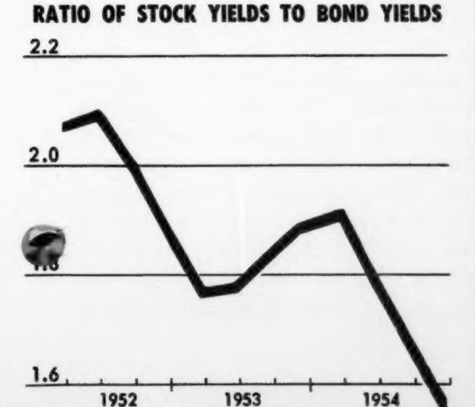
Moreover, there is a widespread feeling that business fluctuations may be less severe in the future; hence their impact on earnings and stock prices may not be as great as in the past. The many structural changes in our economy make an economic debacle of the 1929-32 variety most unlikely. Thus, the fear of prolonged depression—which has colored common stock appraisals for the past quarter century—is beginning to fade away.

No "New Era"

All this definitely does not mean that we are in a "new era" of constantly rising stock market prices. The rise in the past year has been extraordinarily rapid. Clearly, such an advance cannot continue indefinitely. Over a longer period the average of stock prices must be geared to a growth of earnings, which in turn are intimately tied to the growth of the nation's economy.

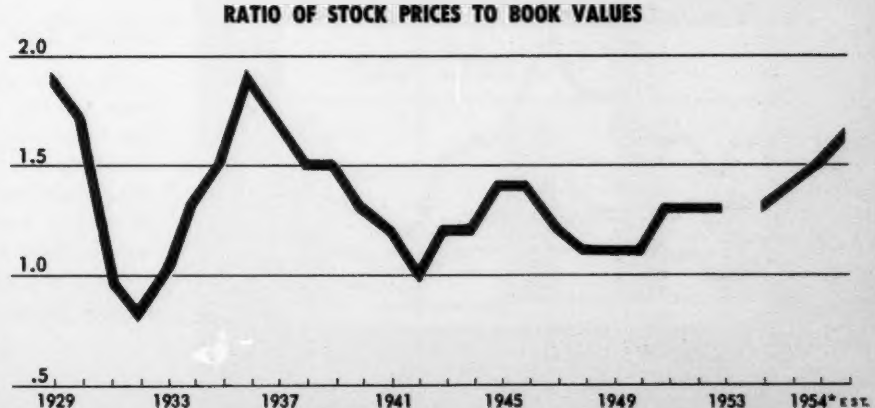
Yet the 1954 rise in the market may well serve to assist this process of growth. It has lifted stock prices into an area where an increasing number of companies can afford to finance capital investment by issuing common stock. Thus stock prices, if they can achieve stability at a reasonably high level, can make an important contribution to an orderly advance for business generally.

RATIO OF STOCK YIELDS TO BOND YIELDS



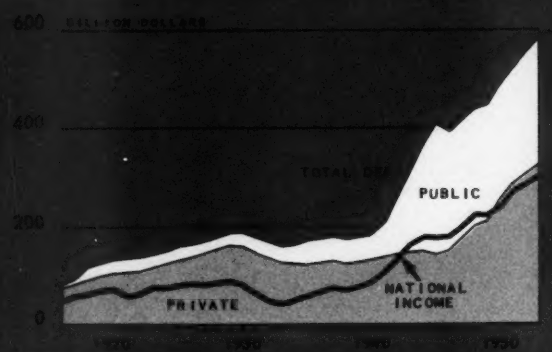
DATA: DOW-JONES AND MOODY'S INVESTORS' SERVICE

RATIO OF STOCK PRICES TO BOOK VALUES

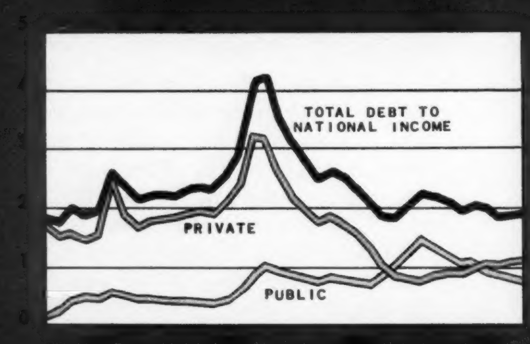


DATA: DOW-JONES AND CO., INC.

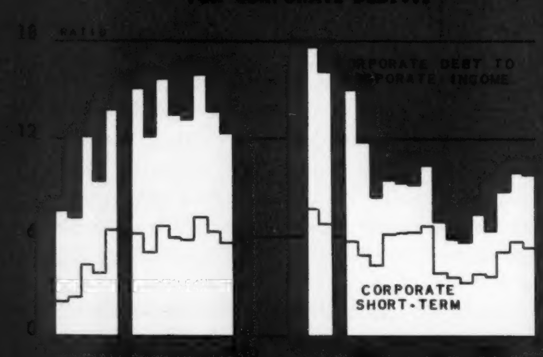
TOTAL DEBT REACHES A NEW HIGH



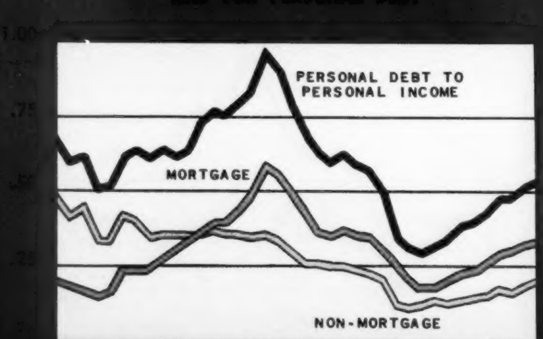
BUT RATIOS TO INCOME ARE MODERATE FOR ALL DEBT



FOR CORPORATE DEBT...



AND FOR PERSONAL DEBT



PUBLIC AND P

Debt has risen rapidly in the post-war period. Total debt is up 47% since 1946. Government debt, however, has shown little rise. Thus, the main advance has been in private debt; it has increased $175 billion and is more than double the 1946 level. Has the post-war rise in debt gotten out of hand?

Debt, if not excessive, performs two essential functions. It finances new investment. And it supports the growth of the money supply. When debt is rising at a reasonable pace, the expansion of bank deposits and currency circulation it generates contributes to general prosperity. For more money is needed to finance increased output if economic growth is to go hand in hand with a stable price level. History shows that debt aways grows in periods of prosperity.

But speculative increases in debt can sometimes be excessive, and lead to economic collapse. Excessive stock market and real estate debt in the late 1920's may have led to the subsequent drop and certainly intensified it. How do you determine whether debt is soundly based or excessive?

The Relation Between Debt and Income

The absolute level of debt by itself does not have much significance. You must look at the income from which it must be financed—total debt must be considered in relation to total income, just as a company's debt should be considered in relation to its income.

Considered in this context, the rise in debt in recent years has been healthy. For income has generally risen as fast as debt. So the ratio between the two has remained stable.

Moreover, the ratio between total debt (private and public) is still a good deal below the level of the 1920's. The ratio reached 2.4 in 1928 and is 1.9 today. And when you look at the main components of the total, the picture looks even better.

Most of today's public debt is federal. In 1928 it made up only 22% of national income. It rose to 127% of national income in 1946 and then declined to 74% in 1953. Since the federal government, unlike private business, is under no pressure to liquidate debt in a recession, this debt is relatively more stable than private debt.

Private Debt

Thus, the major problem of the post-war period has been the rise in private debt. Since 1946, private debt has been rising much faster than income, and so the ratio between the two is up. This increase cannot continue indefinitely, or debt will reach dangerous and vulnerable levels. If debt gets too high in relation to income there will be pressure to liquidate it if the economic going gets rough. If business, farmers, and consumers should all be forced to liquidate high levels of

PRIVATE DEBT

debt at once, a mild dip in production could snowball into a major cumulative decline.

Thus far the rise in private debt has been manageable. In fact, the strength of private debt in 1953-54 helped stabilize the economy.

Corporate debt is the largest component of private debt, both in absolute terms and in relation to income (in this case, corporate income after taxes). The total corporate debt-income ratio is well below the level of the 1920's.

Farm debt, in relation to farm income, is in the healthiest shape of all. The debt-income ratio is still less than one-half of the ratio that prevailed in the 1920's—reflecting the long-run improvement in the farmer's position.

Personal Debt

Mortgage debt, both in absolute terms and as a proportion of personal income after taxes, is the most important part of personal debt. As a result of the post-war housing boom, mortgage debt reached a record level of $84 billion in 1953 (as compared to $28 billion in installment credit). The mortgage debt-income ratio is fast approaching the 1929 peak.

However, mortgage debt is in far sounder shape today than in the past. Interest rates are lower. Amortization is almost universal. Burdensome secondary mortgages have been eliminated. And repayment periods are longer. Thus the total amount of a mortgage is rarely subject to immediate call or default today. In addition, extensive government guarantees are designed to provide strong insurance against the kind of financial panic which led to wide-scale mortgage liquidation in the early 1930's.

One other type of personal debt, installment credit, has risen sharply. Debt-income ratios here have reached their highest pre-war levels. But a look at who holds installment debt shows that it, too, is still not excessive:

- Low income groups (families with income under $3000) are not heavily burdened with debt. They receive 16% of personal income and owe 19% of personal debt.

- It is the middle income families who owe most of the debt—they receive 31% of personal income and owe 40% of the debt. In general, the amount of installment debt owed by these families is well within their ability to repay it.

- If you classify installment debt by the age of holders, you find that the age groups with the greatest potential earning power have the most debt: 76% of all young married people with children have personal debts; only 26% of older single people have debt.

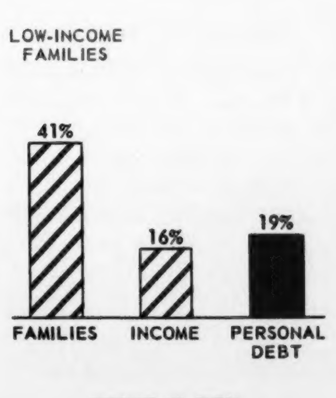
- Debt looks even better if paired against income and liquid assets. Only 13% of all spending units have debts equal to a fifth or more of their income—and of these, half own liquid assets in excess of their debt.

Less Speculation

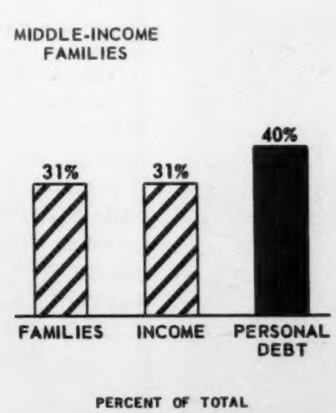
Brokers' loans amount to only $1.5 billion today. That's less than 2% of the value of listed securities as compared to 10% in 1929. Real estate financing shows few of the speculative ear-marks of earlier periods. And other areas of debt, as we have seen, are soundly based in relation to income.

A speculative rise in debt will ultimately result in forced liquidation. The boom of the 1920's may have carried within it the seeds of its own destruction. The post-World War II period, however, shows little evidence of a dangerous degree of speculative activity. The post-war rise in debt still must be classed as moderate. And a moderate rise in debt is an essential condition of a growing and prosperous economy.

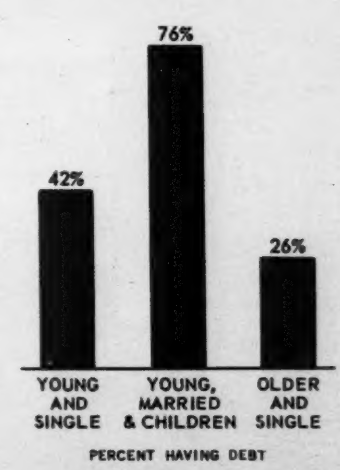
PERSONAL DEBT IS HELD PARTLY BY LOW-INCOME FAMILIES...



BUT MAINLY BY MIDDLE-INCOME GROUPS...



AND CLOSELY CONNECTED WITH THE FAMILY LIFE CYCLE



DATA: FEDERAL RESERVE BOARD

FOREIGN TRADE

A pick-up in commercial exports helped hold U.S. business high last year. Commercial shipments abroad totaled an estimated $12.7 billion, a gain of better than $400 million over 1953.

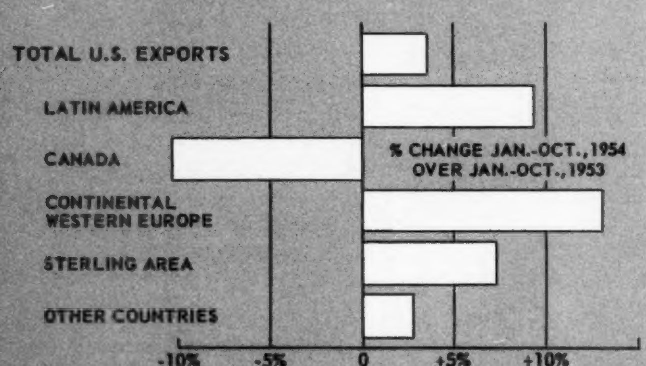
Prospects are bright for even larger export volume this year. Shipment of surplus farm products abroad is expected to boost agricultural exports substantially. Industrial exports are likely to show a more moderate increase.

Trade With Major Areas

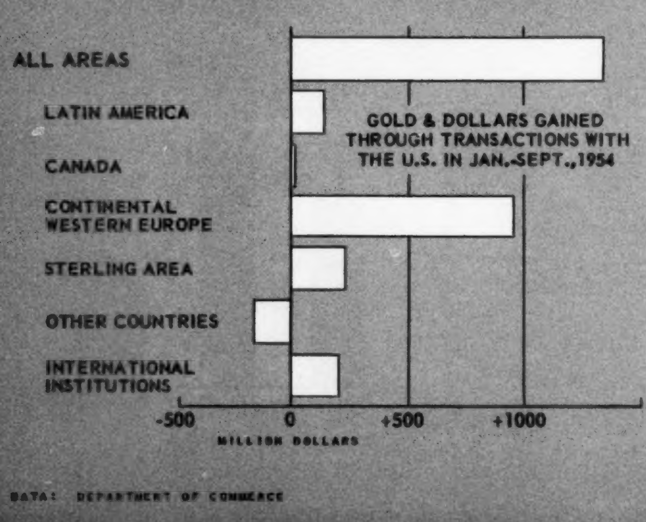
Figures for ten months of 1954 show that exports were higher to all areas except Canada. Shipments to Continental Western Europe rose 13%, reflecting both record business activity there, and the easing of restrictions on dollar imports. Sales to Latin America climbed 9%—the increase was concentrated almost wholly in Brazil (+61%), and Colombia (+21%).

In addition to the $12.7 billion of commercial exports last year, the U.S. shipped about $2.3 billion of goods paid for under the Mutual Security Program. MSP shipments had totaled $3.5 billion in 1953.

U.S. EXPORTS TO MOST AREAS ROSE LAST YEAR ...



YET MOST AREAS CONTINUED TO GAIN GOLD AND DOLLARS



DATA: DEPARTMENT OF COMMERCE

U.S. imports were down about 6% last year, paralleling closely the moderate decline in U.S. industrial activity. Purchases were lower from all areas except Africa.

Foreign Countries Gain Reserves

Nevertheless, foreign countries as a whole continued to earn more dollars than they spent. As a result, they once again accumulated gold and dollars at an impressive rate through transactions with the U.S. The world-wide gain totaled $1.35 billion in January-September 1954, compared with $1.91 billion in the same period a year earlier.

Continental Western Europe again accounted for the largest share of this gain—$948 million in nine months. The sterling area continued to add to its gold and dollar reserves. Moreover, both Europe and the sterling area made these gains while increasing purchases from the U.S. and making substantial dollar repayments to the U.S., Canada and the International Monetary Fund. Thus these areas once again demonstrated their growing financial strength.

Trade Outlook is Good

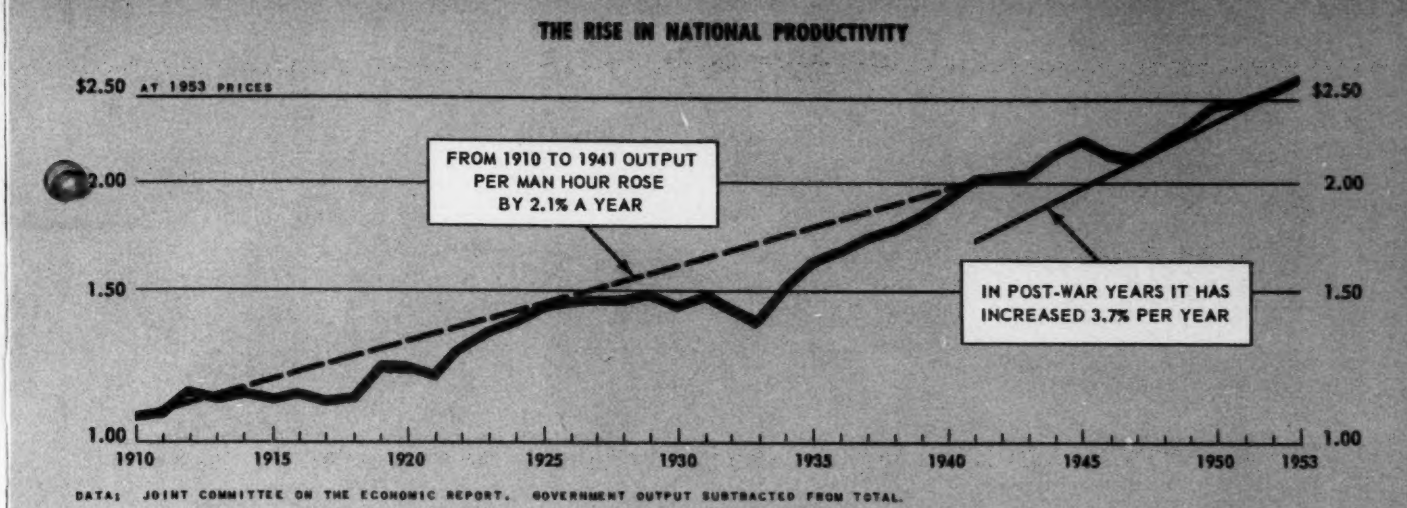
From this record it is clear that many countries have current dollar earnings adequate to buy more from the U.S. if they choose to. In addition, U.S. imports are expected to pick up moderately during 1955. That would add further to the dollar supplies available to pay for U.S. exports.

However, the actual trend in U.S. exports will also depend on the degree of prosperity in foreign markets. If European prosperity is maintained and Canadian business activity rises in line with the expected pick-up in the U.S. economy, it is likely that U.S. sales of industrial products to those markets will increase in 1955. In addition, shipments of surplus farm commodities are expected to rise substantially this year.

These gains will probably more than offset declines in sales to some countries in Latin America and Asia that have recently developed foreign exchange shortages. Thus commercial exports are likely to remain a strong plus factor in the U.S. economy in 1955.

Problems Ahead

This, however, does not mean that we can treat the dollar problem as a thing of the past. Foreign countries still receive more than $3 billion a year through U.S. military expenditures abroad and foreign economic aid. The current high level of U.S. trade depends in part on these payments, which cannot be regarded as permanent or stable. That is why the Administration is giving high priority this year to questions of foreign economic policy, questions which vitally affect the interest of so many U.S. businesses.



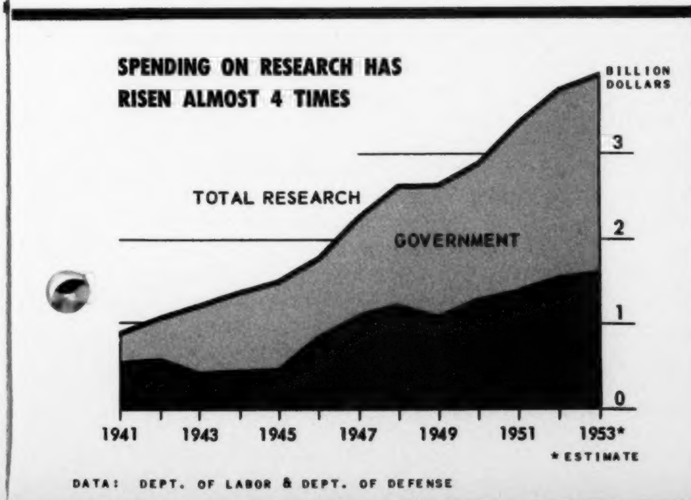
PRODUCTIVITY

American productivity is the envy of the world. And in the post-war period it has been rising faster than ever. From 1909 to 1942, productivity per man-hour (gross national product divided by the number of man-hours worked per year) grew at the remarkable rate of 2.1% a year. In the post-war period it has been growing at the even more remarkable rate of 3.7% per year.

Our long-run rate of growth has been at least one-third higher than that of any other industrial country. What accounts for this extraordinary rise? Will it continue? To answer this question, you must look at trends in the most important factors influencing productivity.

1. **Resources:** The United States has been generously endowed with a moderate climate, fertile soil, and a rich supply of minerals. These have helped the U.S. in the primary industries. Thus, before the war, U.S. productivity was four times greater than British productivity in mining, but only two times greater in manufacturing.

As our mineral resources are used up, some of this advantage may go. However, U.S. business has been adept in developing economic methods for handling lower grade ores (as in copper), finding substitute products (as nylon for silk), and making more effective use of raw materials (an example: the electrolytic tin plating process). So our advantage here should continue to be substantial for many years to come.



2. **Size:** Efficiency requires specialization. And specialization often requires large markets. Most small countries, for example, cannot support an integrated auto plant or a steel mill big enough to be most efficient. Or when they can, they can only support a monopolistic one. But the huge size of American markets allows competition between many large and efficient firms.

3. **Competition:** In part because of its size, therefore, the U.S. is competitive. In Europe, inefficient firms are sometimes insulated by custom barriers and cartels. The U.S. is the largest free-trade area in the world. And within our borders, our anti-trust laws insure a dynamic and progressive competitive spirit.

4. **Labor and Management:** American labor is unusually mobile, alert and well educated. The U.S., for example, turns out three times more college graduates (per capita) than Great Britain, and far more than most other countries. American labor is quick to move into new industries and new areas. Management is quick to adapt itself to new methods and new ideas.

5. **Investment and Research:** Finally, the U.S. has spent tremendous amounts on investment and research. Corporations have invested $160 billion in the post-war period alone, much of it in more efficient facilities.

Meanwhile, research has more than kept pace. At present, the U.S. spends seven times more (per capita) on scientific research than Great Britain. Comparisons with other countries are even more striking.

Consequently, the basic factors underlying the growth in productivity now seem to be as strong as ever. In fact, our increased emphasis on research and development may make our potential for driving up productivity even greater than in the past.

These hands can borrow from any bank in town

A frank statement about loans . . . how they're made . . . why they're sometimes turned down.

. . .

The hands above belong to a skilled craftsman. He's a solid citizen and a hard worker. He's also proud of his work, independent about money as a hog on ice, and downright strait-laced about meeting his obligations.

That makes him a good risk for any banker. Here's why.

Your Money at Stake

Most of the money in banks is money that belongs to the public . . . money that you deposit in your bank. Bankers therefore must see to it that this money of *yours* is lent out only when there's an excellent prospect of its being paid back. That's why occasionally some loan applications are turned down.

Willing to Take a Risk?

Bankers naturally like to lend money. That's their principal source of income. They'll take a considered risk but they can't afford to take long chances with other people's money. All in all, it speaks well for American business and the individual American that the great majority of loan applications are granted. When you hear someone growl about being turned down, ask yourself this question:

"Would I be willing to risk my own money on this promise to pay?"

You might or you might not. Bankers make mistakes, too. But the difference between a bank and an individual is that a bank has to have a high batting average in order to stay in business.

Banker's Judgment

There you have it. The banker has to be somewhat of a financial perfectionist. You may not always agree with his judgment but of this you can be constantly certain: his decisions are based on experience and old-fashioned horse sense. He makes them competitively, knowing that you can always go to another bank. As long as this remains banking's way of doing business, your money will be in good hands.

The Chase National Bank is proud of banking's contribution to the progress of our country.

The CHASE National Bank
OF THE CITY OF NEW YORK
(Member Federal Deposit Insurance Corporation)